Supreme Court, U.S.
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No. 04-1566 (5)

In the Supreme Court of the United States

THEIS RESEARCH, INC.,

Petitioner,

v.

BROWN & BAIN
and such present and former Brown & Bain partners, associates, and other personnel responsible for the management and trial of all litigation involving Peter F. Theis and Theis Research, Inc.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY TO BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether courts—as opposed to arbitrators—shall decide challenges to an underlying agreement with an arbitration clause on the ground that the agreement was void and never existed at the outset, in contrast to agreements that are merely voidable.

2. Whether, in a diversity case, state law can render an unlawful underlying agreement, including an arbitration clause and a resulting arbitration award, null and void *ab initio*.

3. Whether, for diversity jurisdiction to review an arbitration award, the amount in controversy is determined by the amount of the award or the amount in issue in the underlying dispute.

Although petitioner requests grant and hold in the alternative, petitioner respectfully submits that plenary review of this case should be joined with consideration of the question presented in *Buckeye Check Cashing, Inc. v. Cardegna*, No. 04-1264, certiorari granted June 20, 2005:

> Whether the Florida Supreme Court erred by holding, consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals, that the Federal Arbitration Act allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality.

Rule 29.6 Statement: As stated in the petition, there is no parent or publicly held company owning 10% or more of the stock of petitioner Theis Research, Inc.

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INTRODUCTION

Contrary to the claims of Brown & Bain (B&B) in its opposition, this case raises the questions presented in the petition. The issues were decided and are ripe for review.

While B&B argues that the first two questions are not worthy of review, the Court's recent grant of certiorari in *Buckeye Check Cashing, Inc., v. Cardegna*, No. 04-1264, establishes that they are. For reasons discussed below, this case should be reviewed with *Buckeye* to provide the Court a complete picture for analyzing and resolving the issue to be decided in *Buckeye*. *Infra*, at 8-9.

Petitioner Theis Research, Inc. (Theis) has consistently relied on state law holding that illegality concerning the whole of the underlying agreement—as in this case—nullifies any resulting arbitration award, and that courts will decide the issue regardless of whether it was raised to the arbitrator. *See* pet. at 13, 25-27; *infra*, at 6-7.

Theis asks this Court to grant review to decide questions of law, not to resolve issues of fact. B&B erroneously argues that the legal contentions advanced by Theis rest on a factual predicate as to when it started learning of B&B's simultaneous conflicting representations in violation of California law. It is true that the undisputed evidence establishes that Theis did not learn of any such conflict until after the arbitration.[1] Nevertheless, in both

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[1] Theis demanded jury trial of facts under the FAA, 9 U.S.C. § 4. In dist. ct.: ER 1 at 7; 47 at 4; 60 at 4-5; appellant's br. at 48-49. Blurring the facts and breeding confusion, B&B seeks to turn to its advantage the multiplicity of its varied conflicting interests. The district court referenced the "conflict" (singular) issue raised in the arbitration, but this was the Unisys matter that only concerned Pacific Telesis Group indirectly as a Unisys customer.

the district court and the court of appeals, Theis asserted that factual contention *in addition*—and in the alternative—to the *legal* contentions presented by the petition. *See, e.g.*, appellant's br. at 34-42; appellant's reply br. at 14-24.

Precisely because the illegality of each of B&B's conflict-of-interest violations rendered the legal services agreement void *ab initio*, subsequent events are irrelevant. Nothing could revive an agreement that did not exist in the first place, regardless of when the illegality was discovered or first raised.[2]

ER 12 at 19-21. This did not involve the simultaneous representation of an adverse party or its equivalent (i.e., an integrated subsidiary). Theis noted to the arbitrator that it had learned of B&B's representation of a related party (PacTel Cellular Inc. of Arizona), *id.*, but Theis could not claim this was a conflict under California law. Theis had not yet discovered the internal memorandum disclosing that this was an integrated subsidiary of an adverse party (PacTel Cellular), thereby creating a conflict. ER 19 at 2-4; 42 at 23-24, 34-35; *see* pet. at 7-9.

B&B says it "produced" "complete documentation" of the PacTel Cellular/PacTel Cellular Inc. of Arizona conflict—including the internal memorandum—but B&B buried the memorandum among some 100,000 documents, placed almost 25,000 pages away from the letter referencing the representation of the subsidiary. ER 42 at 18-19 (##B094653-54), 23-48 (##B069817-42). Theis discovered the memorandum after the April 1999 arbitration award, and promptly brought this action—first raising B&B's conflict from its simultaneous representation of an adverse party equivalent. *See* Cal. R. Prof. Conduct 3-310(C). B&B first disclosed on May 9, 2002, its simultaneous representations of AirTouch Communications (fka PacTel Corp.) and three other telephone companies. ER 95 at 1-2; 96 at 8, 12.

[2] Though never given in this case, informed written consent—if given in the midst of a conflicted representation—might

Under both the district court's version (that the PacTel Cellular/PacTel Cellular Inc. of Arizona conflict and its invalidating effect were *not* raised to the arbitrator—and thus were waived, 34a, 38a-40a) and the court of appeals' version (that the conflicts and their invalidating effect *were* raised to the arbitrator—and could not thereafter be considered by a court, 13a), the issue was left for determination by an arbitrator and not considered on its merits by the court. That failure is before this Court as an error of law.

As discussed below, the petition also correctly presents for review the court of appeals' jurisdictional decision.

ANALYSIS

I. The Ninth Circuit Decided the First Two Questions

B&B concedes that Theis sought, in both the district court and the court of appeals, a judicial determination that the legal services agreement was void *ab initio*, and to have the arbitration award vacated as arising from an unlawful, void agreement under state law. Presented with these issues, the Ninth Circuit necessarily decided them adversely to Theis, regardless of whether or not the court detailed them in its opinion.

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legitimize the representation going forward, but it does not change the fact that the representation up to that point was unlawful and therefore void. There is a distinction between (a) *ex ante* informed written consent—which Cal. R. Prof. Conduct 3-310(C) permits, and (b) *ex post facto* waiver of an unlawful contract—which California law does *not* permit. *City Lincoln-Mercury Co. v. Lindsey*, 52 Cal. 2d 267, 274 (1959); *International Assn. of Fire Fighters v. City of San Leandro*, 181 Cal. App. 3d 179, 182 (1986). *Accord Chambers v. Kay*, 29 Cal. 4th 142, 146, 155-156, 158 (2002)(recognition "untenable").

Contrary to B&B's claim (opp. br. at 5), Theis accurately recounted the position taken by the Ninth Circuit in this case—that even for admittedly meritorious claims of unlawful conflicts of interest, private arbitrators should have the final say in deciding the legality of underlying agreements, even when they undermine the judicial process. Pet. at 3 (n.1 omitted).[3]

The Ninth Circuit expressly held that Theis could not obtain a judicial determination on the merits of whether the legal services agreement was void *ab initio*, leaving untouched the purported decision of the arbitrator on this issue. App. at 13a.

B&B errs in suggesting that this Court cannot consider whether a court should now rule on the void-*ab-initio* issue. For example, in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), this Court considered whether a court or an arbitrator should decide the availability of a class action under an arbitration clause. The Court did not consider the question foreclosed because arbitration awards had already been rendered. The plurality opinion found that such an issue should be remanded to the arbitrator, but it raised a distinction that should be applied in this case:

> In certain limited circumstances, courts assume that the parties intended courts, not arbitrators, to decide a particular arbitration-related matter .... They include certain

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[3] As noted in the petition, by the time it filed its appellee's brief in the most recent appeal to the Ninth Circuit, B&B finally admitted its conflict as to Pacific Telesis Group/AirTouch Communications (fka PacTel Corp.), as well as its conflict as to PacTel Cellular/PacTel Cellular Inc. of Arizona (also conceded in the internal memorandum). Pet. at 3 n.1, 8-9, 10 n.18.

> gateway matters, such as whether the parties have a valid arbitration agreement at all . . ..

Id. at 452. Even as to the issue in *Green Tree*, the dissent of the Chief Justice asserted that "this determination is one for the courts, not for the arbitrator, ..." *Id.* at 455. *See Discover Bank v. Superior Court*, No. S113725, slip op. at 27-29 (Cal. June 27, 2005)(courts decide enforceability).

The Ninth Circuit did not discuss state law because it did not apply it, thereby deciding *sub silentio* against Theis' contentions under state law.

B&B makes the extraordinary misstatement that "this diversity case was decided under the law of California." Opp. br. at 6. Even though it should have applied state law, the Ninth Circuit did not even purport to do so, disregarding principles of federalism embodied in both the Rules of Decision Act, 28 U.S.C. § 1652, and the Federal Arbitration Act, 9 U.S.C. § 2.

B&B misstates California law (opp. br. at 6 n.1) when it erroneously accuses Theis of the same thing:

> TRI[Theis]'s contention that "California authorities hold uniformly that unlawfulness may be raised at any time, including raising unlawfulness for the first time on a motion to vacate, or in opposition to a motion to confirm," (Pet. at 26) is simply wrong. *See, e.g., Loving & Evans v. Blick*, 33 Cal. 2d 603, 604-05 (1949); *South Bay Radiology Medical Assoc. v. W. M. Asher, Inc.*, 220 Cal. App. 3d 1074, 1078 (1997 [*sic*: 1990]); *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th 882, 886 (1997); *Alternative Systems, Inc. v. Carey*, 67 Cal. App. 4th 1034, 1040 (1998).

B&B is wrong. Taking B&B's cited cases seriatim:

- In *Loving & Evans*, the California Supreme Court explained that:

> [T]he rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable where the issue of illegality of the entire transaction is raised in a proceeding for the enforcement of the arbitrator's award.

33 Cal. 2d at 609. It made no difference that *both* sides had jointly submitted their dispute to arbitration "in line with" the underlying agreement. *Id.* at 604.

- Discussing *Loving & Evans*, the court in *South Bay Radiology* stated that:

> [T]he rationale the court employed makes it clear the illegality defense may be raised for the first time in opposition to a motion to confirm.

220 Cal. App. 3d at 1080-1081 (even though the assertion of illegality failed as a matter of substantive law, *id.* at 1079-1080, the court still held that the assertion of illegality could be raised at any time).

- The court in *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th at 892, stated that:

> [I]t did not matter that Staff Builders had submitted the illegality issue to the arbitrator or that the arbitrator had decided that issue.

The *Lindenstadt* court also noted, *id.* at 893 n.8:

> In determining the illegality question, the trial court should consider all of the admissible evidence submitted to it regardless of whether that evidence was before the arbitrator.

• Citing *Loving & Evans*, the court in *Alternative Systems* stated the same rule:

> The defense of illegality of the entire transaction can be raised at any stage of the proceeding, including opposition to a motion to confirm.

67 Cal. App. 4th at 1040.

The Ninth Circuit undeniably refused to apply California law to decide this case. That refusal is ripe for review.

II. The Questions Presented Are Worthy of Review

A. The Grant of Certiorari in *Buckeye* Establishes That the First and Second Questions Are Worthy of Review

In the petition, Theis cited the Florida Supreme Court's decision in *Cardegna v. Buckeye Check Cashing, Inc.*, 894 So. 2d 860 (Fla. 2005). That court is one of several state high courts in conflict with several circuits over the issue of whether an arbitration clause is void and without effect when it is embedded in an illegal contract. Pet. at 24-25. On June 20, 2005, this Court granted certiorari to review that case, *sub nom. Buckeye Check Cashing, Inc., v. Cardegna*, No. 04-1264. B&B's protestations notwithstanding (opp. br. at 6), the questions present an issue of federal law and are worthy of review.[4]

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[4] The Ninth Circuit's refusal to apply state law in this case by itself presents a federal question, and the effect to be given such state law is an important and recurring question under the Federal Arbitration Act. The FAA has a broad reach (co-extensive with the Commerce Clause); the state arbitration statute cited by the California Supreme Court in *Loving & Evans*

B. Plenary Review of This Case with *Buckeye* Is Essential to Provide a Complete Perspective of the Whole Issue Implicated by *Buckeye*

This case presents a more complete picture about how to approach the issue.

The Court might well determine that *any* illegality in an underlying contract renders the entire contract—including an arbitration clause—void *ab initio*. Or the Court might defer to state law to determine whether the illegality has such an effect on the entire contract.

But the Court might instead determine that the answer turns on whether the unlawful provision is *severable* from an otherwise valid contract that contains the arbitration clause. If the illegality voids the entire contract, there is no surviving arbitration clause—and no power could have been conferred on an arbitrator. Conversely, illegality of a single provision, if severable, does not void the remaining lawful agreement. In that instance, the arbitration clause survives with the remainder of the contract; the parties' dispute is arbitrable; and even the illegality challenge to the single provision may be presented to the arbitrator—at least in the first instance.[5]

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tracks the text of the FAA, 9 U.S.C. § 10(a)(4); and the California Supreme Court explicitly acknowledged the applicability of the FAA when deciding in *Rosenthal v. Great Western Financial Securities Corp.*, 14 Cal. 4th 394, 416 (1996) that: "If the entire contract is void *ab initio* . . ., the parties have not agreed to arbitrate any controversy; . . .." Pet. at 17, 25-26.

[5] Potentially, if the unlawfulness turns on the interpretation of a single provision of the contract, the arbitrator might construe that provision so as to avoid a conflict with state law.

The latter analysis is the approach taken by the California courts. In this case, the illegality goes to the very formation of the purported contract—rendering the entire agreement void *ab initio*. B&B violated California conflict-of-interest law by purportedly entering into the legal services agreement to represent Theis. B&B lacked lawful capacity to enter into such an agreement.

As discussed above, under the California approach, unlawfulness is decided by the court if the challenge applies to the agreement as a whole—such as in this case, where illegality concerns the formation of the purported contract. In such cases, it does not matter whether or not the unlawfulness was raised to the arbitrator. *Supra*, at 6-7.

In *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992), the California Supreme Court distinguished the circumstance in the present case—where Theis challenges the entire legal services agreement because B&B entered into it in violation of California law:

> Both *Loving & Evans*, *supra*, 33 Cal. 2d 603, and *All Points Traders*, *supra*, 211 Cal. App. 3d 723 [(1989)], permitted judicial review of an arbitrator's ruling where a party claimed the entire contract or transaction was illegal. By contrast, Moncharsh challenges but a single provision of the overall employment contract.

3 Cal. 4th at 32. The court determined that the arbitration clause survived in an otherwise valid employment contract and that enforceability of the single provision should have been submitted to the arbitrator.

Whatever this Court ultimately determines to be the rule, the Court can best analyze, frame, and settle the issue by reviewing this case with *Buckeye*.

III. The Third Question Is Also Properly Presented

B&B misreads the Ninth Circuit's opinion. For the amount in controversy to review an arbitration award, the court framed its choices as the amount of the award or the amount disputed in the underlying litigation. App. at 4a-5a. It did not choose the amount of the award, conflicting with Sixth and Eleventh Circuit decisions. The amount in the "underlying litigation" concerned the arbitration claims, which the court treated interchangeably with damage claims in the complaint. App. at 4a. *But cf.* pet. at 30 n.43 (new conflict claims could anchor but then not precluded).

If the court had simply relied on the damage claims in the complaint (apart from arbitration claims), it would have treated these as a subject matter anchor and then invoked supplemental jurisdiction under 28 U.S.C. § 1367 for review of the arbitration award.[6] The court did not do so.

CONCLUSION

Theis requests that the petition be granted for plenary review. In the alternative, Theis requests grant and hold pending the Court's decision in *Buckeye*.

Respectfully submitted,

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[6] Reasserting arbitration claims could then fabricate jurisdiction.

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CORPORATE DISCLOSURE

On July 1, 2004, Brown & Bain P.A. changed its name to Perkins Coie Brown & Bain P.A. Perkins Coie Brown & Bain P.A. is an Arizona professional corporation and a partner of Perkins Coie LLP. It has no parent corporation, and no publicly-held corporation owns 10 percent or more of its stock.

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STATUTES

Supreme Court Rule 15(8) 1

I. Introduction

Brown & Bain submits this supplemental brief in response to TRI's suggestion, first made in reply, that its petition for writ of certiorari should be reviewed with *Buckeye Check Cashing, Inc. v. Cardegna, et al.*, No. 04-1264, "to provide the Court a complete picture for analyzing and resolving the issue to be decided in *Buckeye*." Reply at 1.[1] In fact, the issue in *Buckeye* is so utterly distinct from those presented here that whether the Court affirms or reverses in *Buckeye* can have no impact on its disposition of TRI's petition.[2]

II. Argument

In *Cardegna v. Buckeye Check Cashing, Inc.*, 894 So.2d 860 (2005), the Supreme Court of Florida held that:

> where a party sufficiently alleges that a contract is void for violation of Florida's usury laws, the Florida courts, and not an arbitrator, must first determine the contract's legality before a party may be required to submit to arbitration under a provision of the contract.

Id. at 865. The reason given by the court was that "if the underlying contract is held entirely void as a matter of

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[1] This supplemental brief is submitted pursuant to Supreme Court Rule 15(8). Certiorari was granted in *Buckeye* on June 20, 2005, the date on which Brown & Bain's opposition brief was filed.

[2] The question presented in *Buckeye* is: "Whether the Florida Supreme Court erred by holding, consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals, that the Federal Arbitration Act allows a party to avoid arbitration by claiming that the underlying contract containing an arbitration clause (but not the arbitration clause itself) is void for illegality."

law, all of its provisions, including the arbitration clause, would be nullified as well." *Id.* at 863. Therefore, "as arbitration depends on a valid contract an argument that the contract does not exist can't logically be resolved by the arbitrator." *Id.* at 863, *quoting Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001). Not one of the issues identified by the Florida court is presented here.

First, unlike the respondent in *Buckeye,* TRI was not "*required* to submit to arbitration under a provision of the contract." *Buckeye*, 894 So.2d at 865 (emphasis added). On the contrary, TRI *voluntarily* submitted to arbitration with full knowledge of the conflict it later sought to allege in the district court. *See* App. at 13a; 31a; 39a-40a. Nor was the authority of the arbitrator to adjudicate TRI's claims premised on the parties' legal services agreement. On the contrary, by knowingly and voluntarily participating in arbitration, TRI conferred jurisdiction on the arbitrator regardless of whether the legal services agreement was void, voidable, or fully enforceable.

The jurisdiction of an arbitrator is derived from the consent of the parties, whether that consent is expressed in an arbitration agreement or by knowing participation in the arbitration itself. *See, e.g., Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989) (arbitration is a matter of consent; parties are free to structure their agreement as they see fit). In *Ficek v. Southern Pacific Co.*, 228 F.2d 655 (9th Cir. 1964), for example, the court of appeals rejected a collateral challenge to the validity of an arbitration award, premised on the arbitrator's lack of authority, on the ground that plenary authority was conveyed by the parties' participation in the arbitration:

> It is true that arbitration is a matter of contract, and that one is bound by an award only if he agreed to submit the dispute to arbitration. But an agreement to arbitrate a particular issue need not be express – it may be implied from the conduct of the parties.

Id. at 656; *see also Nghiem v. NEC Elec., Inc.*, 25 F.3d 1437 (9th Cir. 1994) ("Nghiem's voluntary initiation of arbitration can be interpreted as waiver of any objection he may have had over the authority of the arbitrator."). Here, as the court of appeals held, by voluntarily submitting Brown & Bain's alleged conflict to arbitration, TRI waived its right to relitigate that claim in the district court. *See* App. at 13a.

Second, the parties in *Buckeye* expressly agreed that their arbitration agreement was to be governed by the Federal Arbitration Act. *See Buckeye*, 894 So.2d at 861. Here, in contrast, the parties agreed to arbitrate pursuant to the procedural rules of the American Arbitration Association (*see* ER 7 at 18) and the substantive law of the State of California. *See* Pet. at 10. The validity of such agreements has long been recognized. *See Volt,* 489 U.S. at 479; *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1209 (9th Cir. 1998) (parties are free to contract around the FAA by incorporating other rules into their agreements). Therefore, whatever the Court may decide as to the requirements of the Federal Arbitration Act in *Buckeye*, those requirements are without effect in cases, such as this, in which the parties have agreed to arbitrate under other rules.

Third, unlike the "entirely void" contract in *Buckeye*, the legal services agreement between Brown & Bain and

TRI was, at most, merely voidable. As the district court held:

> When TRI became aware that [Brown & Bain] had a conflict of interest that it failed to disclose, TRI could have elected to seek release from the retainer agreement. TRI could also have waived the conflict. The contract was thus voidable, not void. *See* Rest. 2d Contr. § 7, comment b; Cal. R. Prof. Cond. Rule 3-310.

App. at 39a. This distinction was crucial to the decision of the Florida Supreme Court in *Buckeye*, which distinguished *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) on the ground that the agreement at issue in *Prima Paint*, like that at issue here, was voidable rather than void.

III. Conclusion

TRI's petition for writ of certiorari should be denied for the reasons stated in Brown & Bain's opposition brief. Its belated suggestion that the Court hold that petition for review with *Buckeye* should be denied for the reasons stated above.

Respectfully submitted,

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